FILE COPY

Office Supreme Court, U. S.
FILED
JAN 4 1936
CHARLES ELMORE CROPLEY
CLERK

Nos. 226 and 227

In the Supreme Court of the United States

OCTOBER TERM, 1935

MANHATTAN GENERAL EQUIPMENT COMPANY, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

COLLIER SERVICE CORPORATION, FORMERLY BROADWAY SUBWAY ADVERTISING CO., INC., PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT

INDEX

	Page
Opinions below	1
Jurisdiction	2
Question presented	2
Statutes and regulations involved	3
Statement	3
Summary of argument	6
Argument	7
Conclusion	20
Appendix	21

CITATIONS

Cases:	
Arizona Grocery v. *Atchison Ry.*, 284 U. S. 370	14, 15
Bamberger v. *Commissioner*, 27 B. T. A. 785, 67 F. (2d) 983	17, 18
Burnet v. *Chicago Portrait Co.*, 285 U. S. 1	13
Burnet v. *S. & L. Bldg. Corp.*, 288 U. S. 406	17, 18
Great Northern Ry. v. *Sunburst Co.*, 287 U. S. 358	16
Larkin v. *United States*, 78 F. (2d) 951	18
Langstaff v. *Lucas*, 9 F. (2d) 691, affirmed, 13 F. (2d) 1022, certiorari denied, 273 U. S. 721	18
Lynch v. *Tilden Co.*, 265 U. S. 315	13
Minnesota Rate Cases, 230 U. S. 352	13
Morrill v. *Jones*, 106 U. S. 466	13
Murphy Oil Co. v. *Burnet*, 287 U. S. 299	13, 17, 18
Shearer v. *Anderson*, 16 F. (2d) 995	18
Standard Oil Company of New Jersey v. *Southern Pacific Company*, 268 U. S. 146	13
Titsworth v. *Commissioner*, 73 F. (2d) 385	13
Statutes:	
Revenue Act of 1921, c. 136, 42 Stat. 227: Sec. 1314	16
Revenue Act of 1924, c. 234, 43 Stat. 253: Sec. 1008 (a)	16

39477—36——1

Statutes—Continued.

	Page
Revenue Act of 1926, c. 27, 44 Stat. 9:	
Sec. 203	21
Sec. 204	21
Sec. 1108 as amended	16, 22
Revenue Act of 1928, c. 852, 45 Stat. 791:	
Sec. 605	22
Revenue Act of 1934, c. 277, 48 Stat. 680:	
Sec. 506	17
Miscellaneous:	
H. Rep. No. 704, 73d Cong., 2d Sess., p. 38	17
I. T. 2152, IV–1 Cumulative Bulletin 83	16
S. M. 2216, III–2 Cumulative Bulletin 370	16
S. Rep. No. 558, 73d Cong., 2d Sess., p. 48	17
T. D. 4144, VII–1 Cumulative Bulletin 55	23
T. D. 4274, VIII–2 Cumulative Bulletin 240	23
Treasury Regulations 65, Art. 1599	8
Treasury Regulations 69, Art. 1599	22

In the Supreme Court of the United States

OCTOBER TERM, 1935

No. 226

MANHATTAN GENERAL EQUIPMENT COMPANY, petitioner

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

No. 227

COLLIER SERVICE CORPORATION, FORMERLY BROADWAY SUBWAY ADVERTISING CO., INC., petitioner

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 27–35)[1] is reported in 29 B. T. A. 395. The opinion

[1] The records have been separately printed. However, the cases were consolidated before the Board of Tax Appeals

of the Circuit Court of Appeals (R. 45–53) is reported in 76 F. (2d) 892.

JURISDICTION

The judgments of the Circuit Court of Appeals were entered April 22, 1935 (R. 60). A petition for rehearing was denied May 22, 1935 (R. 64). The petition for writs of certiorari was filed July 8, 1935, and was granted October 14, 1935. (R. 67.) The jurisdiction of this Court rests on Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Under Regulations 69, Article 1599, as originally promulgated *August 28, 1926,* where stock distributed to a shareholder in reorganization of the distributing corporation was of a different character from that of the distributing corporation, the cost basis of the old shares was to be divided between such old stock and the new stock in proportion to the respective values of the old and new stock at the time the new was distributed; *provided*, that the portion to be attributed to the new shares should in no case exceed the fair market value of such shares as of the time of their distribution. On *April 3, 1928,* the original regulation was amended by striking out the *proviso* clause.

(see *Record in Manhattan General Equipment Company case*, p. 1), and disposed of in a single opinion both in the Board of Tax Appeals and in the Circuit Court of Appeals. Unless otherwise indicated, references to the record are to the record in the *Manhattan General Equipment Company case*, No. 226.

The question presented is whether the regulation as amended was properly applied to measure the gain or loss on sale by a stockholder in *December, 1926,* of shares of old stock where the stockholder in *December, 1925,* had received, on a reorganization, distribution of shares in another corporation without surrender of the old shares.

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved appear in the Appendix, *infra.*

STATEMENT

During the year 1926, the petitioners were affiliated with United Brokerage Company and a number of other corporations. A consolidated return for that year was filed on their behalf by United Brokerage Company and the Commissioner determined therefrom the proportion of the tax which should be assessed against each of them (R. 18–22).

On June 30, 1925, the total capital stock (4,964 shares of common) of one of the affiliates, Artemas Ward, Inc., a New York corporation, was acquired by United Brokerage Company at a cost of $3,414,345.63 (R. 23). On December 31, 1925, the total net assets of Artemas Ward, Inc., had a fair value of $1,246,920.07 (R. 24). On that date, Artemas Ward, Inc., transferred all its assets, with the exception of cash and accounts receivable aggregating $284,967.21, to another corporation of the same name organized under the laws of Delaware. The

net value of the assets so transferred was, therefore, $961,952.86 (R. 24–26). In exchange the Delaware corporation issued all its capital stock (100 shares) to the New York corporation (R. 24).

Immediately thereafter, on the same day, the New York corporation distributed to its sole stockholder, United Brokerage Company, the 100 shares of stock of the Delaware corporation, together with accounts receivable aggregating $234,967.21. Thus: "All of the assets of the New York corporation were taken from it with the exception of $50,000 in cash, so that the 4,964 shares were backed by nothing more than $50,000 in cash. The 100 shares of Delaware corporation stock were backed by practically all of the remaining assets which had formerly belonged to the New York corporation" (R. 34)—and the net value of those assets was $961,952.86. (R. 24–34.)

In December 1926 United Brokerage Company, in two transactions, sold to one George B. Anderson, an outsider, all of its stock (4,964 shares) in the New York corporation for $49,640 (R. 10, 24–25). The sole question involved in this case relates to the method for computing the loss on that sale.[2]

---

[2] Another issue, involving the determination of the proper basis for computing gain or loss on the cancellation of a certain contract, was decided below adversely to the taxpayer. The petition for certiorari, however, states that no review of that question is sought (Pet. 3, note).

In the consolidated return filed by United Brokerage Company, in the petitions to the Board of Tax Appeals, and in the proceedings before it, a deduction of $3,062,314.54 was claimed as a loss resulting from the sale of the stock in the New York corporation through the application—not of subdivision (2) of Article 1599, Regulations 69, of August 28, 1926, for which petitioners now contend (Br. 7–8)—but of subdivision (1) thereof (R. 3, 10, 14, 25, 33, 34, 40). Petitioners for the first time invoked, as an alternative to the use of subdivision (1), the application of subdivision (2) of Article 1599, Regulations 69, of August, 1926, in their petitions for review of the decision of the Board of Tax Appeals by the Circuit Court of Appeals (R. 42).

Following Article 1599 (2) of Regulations 69, as amended (see Appendix, *infra*), the Commissioner computed the loss as follows (R. 26): He prorated the cost ($3,414,345.63) of Artemas Ward, Inc. (N. Y.), between the New York and Delaware corporations on the basis of their net worth as of the time of reorganization. Thus, the stock of the Delaware corporation was given a base of $2,634,041.66, and the stock of the New York corporation a base of $780,303.97. The base of the stock of the New York corporation was reduced by $234,967.21 (which had been distributed to United Brokerage Company), leaving a net base of $545,-336.76. By subtracting the sale price of that stock

($49,640). from the net base, the Commissioner determined a loss of $495,696.76 (R. 26).

The Board of Tax Appeals ruled against petitioners' contention for the application of subdivision (1) of Article 1599, and approved the Commissioner's determination, holding subdivision (1) unreasonable as applied to the situation before it (R. 33, 34); and its decision was affirmed by the Circuit Court of Appeals on the ground that the method of apportionment required by subdivision (2) of Article 1599, Regulations 69, as amended, was not unreasonable and that the Commissioner had the right to apply it to the 1926 transaction because the Regulations were tentative and applicable retroactively to the date of the law (1926) under which promulgated (R. 50–53).

SUMMARY OF ARGUMENT

The applicable statute (Sec. 204 (a) (9) Rev. Act 1926) prescribes that the basis shall be "apportioned" between the old stock and the new stock distributed; and to "apportion" means to divide proportionately. The amended regulation equitably operates under the statute and reaches the result contemplated by it.

The application of the original regulation in this case would conflict with the statute and produce an unreasonable result because it would not apportion or divide the basis proportionately between the old and the new stock. Hence, even should it be deemed legislative in character, it was inapplicable.

The Commissioner was authorized to amend regulations to apply retroactively in order to carry out the intent of the statute and the amendment was a correct administrative interpretation of the statute.

ARGUMENT

Section 203 (c) of the Revenue Act of 1926, *infra*, provides that no gain or loss shall be recognized under the situation presented, and Section 204 (a) (9), *infra*, provides that, on the sale or other disposition of such stock:

> the basis in the case of the stock in respect of which the distribution was made shall be *apportioned*, under rules and regulations prescribed by the Commissioner with the approval of the Secretary, *between such stock and the stock or securities distributed* * * * (Italics supplied.)

On August 28, 1926, the Commissioner promulgated Article 1599 of Regulations 69, *infra*. This regulation (subdivision (1)) provided one rule where all of the stock distributed in reorganization was of substantially the same character or preference as the stock held, and this was the rule which petitioners sought to apply prior to their petition for review by the Circuit Court of Appeals, as heretofore noted. It provided (subdivision (2)) another rule where the new stock was of a different preference. The petitioners now apparently concede that where the new stock is stock of a different corporation it is to be regarded as stock of a dif-

ferent character or preference, even though both are common stock, and insist that apportionment should be made not under the first but under the second rule as originally promulgated as follows:

> Where the stock distributed in reorganization is in whole or in part of a character or preference materially different from the stock in respect of which the distribution is made, the cost or other basis of the old shares of stock shall be divided between such old stock and the new stock in proportion, as nearly as may be, to the respective values of each class of stock, old and new, at the time the new shares of stock are distributed, and the basis of each share of stock will be the quotient of the cost or other basis of the class with which such share belongs, divided by the number of shares in the class. *The portion of the cost or other basis of the old shares of stock to be attributed to the shares of new stock shall in no case exceed the fair market value of such shares as of the time of their distribution.*[3] (Italics supplied.)

This rule was first amended April 3, 1928, by T. D. 4144, VII–1 Cumulative Bulletin 55, which struck out the italicized sentence.[4]

In this case, the Commissioner and the Board have applied the amended rule; that is, the cost of

---

[3] Article 1599, Regulations 65 promulgated October 6, 1924, contained substantially the same language.

[4] The final revision was made in T. D. 4274, VIII–2 Cumulative Bulletin 240, promulgated November 13, 1929, in which the sentence italicized above was also omitted.

the old stock ($3,414,345.63) has been apportioned between the old and new shares in proportion to the value of the 4,964 shares of old stock in the New York corporation and the 100 shares of new stock in the Delaware corporation at the time of the distribution of the new stock, December 31, 1925 (R. 26). By this means, the Commissioner has determined a cost basis of $545,336.76 for the old stock and has ascertained a loss of $495,696.76, the difference between the basis and the selling price.

The petitioners now argue that the second rule of Article 1599 must be applied in the form in which it appeared in the original regulation and hence that the apportionment is subject to the requirement that the portion of the cost allocated to the new shares of the Delaware corporation shall not exceed their fair market value at the time of their distribution, $961,952.86. This would leave the remainder of the cost of the old stock, $2,452,392.77, to be allocated to the old stock of the New York corporation, which had transferred most of its assets to the Delaware corporation. A loss of $2,167,785.56 would thereby be established, instead of the $495,696.76 allowed by the Commissioner (Br. pp. 4–5). This result is as palpably unreasonable as applied to this case as the conclusion reached under the original theory that subdivision (1) of Article 1599 applied, and of which the Board of Tax Appeals said (R. 34):

> It is to be regretted that such a regulation was published and allowed to stand for so many years, but, if the petitioner's contention is correct, the case demonstrates the unreasonableness of that regulation. All of the assets of the New York corporation were taken from it with the exception of $50,000 in cash, so that the 4,964 shares were backed by nothing more than $50,000 in cash. The 100 shares of Delaware corporation stock were backed by practically all of the remaining assets which had formerly belonged to the New York corporation. The net value of these assets was almost a million dollars, yet, under the petitioner's method, $3,111,954.54 of the original basis would be attributed to the New York stock and only $67,423.88 of the basis would be allocated to the Delaware stock.

Section 204 (a) (9), *infra,* provides that the cost basis of the stock shall be *apportioned,* under rules and regulations prescribed by the Commissioner with the approval of the Secretary, *between such stock and the stock or securities distributed.* The Congress must have used the word apportion in its ordinary sense. There is nothing in the statute to indicate that it was used otherwise. The definition of apportion as given in Webster's International Dictionary is "to divide and assign in just proportion; to divide and distribute proportionally." The statute contemplates, therefore, that the cost basis of the old stock shall be proportionally divided be-

tween the old and the new, so that it is the duty of the Commissioner to determine the respective values of the old and the new stock at the time of the reorganization and then to assign to each its proportionate share of the original cost of the old stock. In no other manner can the mandate of the Congress be carried out. The statute vests in the Commissioner no legislative authority. Under it he may not declare the law, since the Congress has already declared it. All the Commissioner is authorized to do is to find certain facts and then apply the law as the Congress enacted it. It is clear that the Commissioner under the authority of this section could not make a regulation providing for a method of apportionment which would ascribe to any given stock a proportion to other stock which it does not mathematically and inherently bear. His authority is merely to interpret the law and then apply it to the facts as he finds them.

Whether the original regulation be termed legislative or interpretive in character its application to the case at bar would be unreasonable and to that extent unauthorized. A statement of the facts demonstrates this. The stock of the old corporation cost United Brokerage Company $3,414,345.63. On the date of the reorganization the assets had a value of $1,246,920.07. Through the reorganization the old corporation was denuded of all of its assets except $50,000 in cash. The stock of the old corporation backed only by the $50,000 cash was

then sold for $49,640. The remainder of the assets of the old corporation amounting to $1,196,920.07 still remained under the control of United Brokerage Company. If the original regulation should be applied to these facts the petitioners would be entitled upon the sale for $50,000 of assets having a cost basis of only about $150,000 to realize a loss for income tax purposes of approximately $2,167,785.56.

A reorganization such as is involved here is not a taxable transaction and it is clear that the statute was not primarily designed to afford taxpayers the opportunity of realizing losses for income tax purposes. The purpose of the reorganization statute is to permit taxpayers to reorganize corporations without realizing a gain for income tax purposes. To permit a taxpayer, after denuding a corporation of practically all of its assets and selling the remaining few assets, to realize a loss for income tax purposes measured by the difference between the original cost of the entire stock of the corporation and the price obtained for the stock after taking from the corporation practically all of its assets, would permit a method of computation which would not clearly reflect the income and would not be within the statute. It would permit the realization of an enormous loss where in fact there was only a small loss.

Had the Commissioner, for example, promulgated a regulation providing that in no case should the new stock be given a value of more than ten

per cent of the cost of the old, it would be unauthorized and could not be applied unless the proportion chanced to be a correct one. So, when the Commissioner made the regulation providing that in no case should the value of the new stock exceed its market value, a computation based thereon would have been unreasonable and unauthorized if in fact the true proportion was greater or less than the market value. Such a regulation is nothing more than a formula and this Court has long held that formulae are nothing more than suggestive guides. *Minnesota Rate Cases,* 230 U. S. 352, 434; *Standard Oil Company of New Jersey* v. *Southern Pacific Company,* 268 U. S. 146. If the application of a formula produces a reasonable result its application will be sustained by the courts. If the result obtained is unreasonable it is beyond the power of the Commissioner to apply the formula. *Murphy Oil Company* v. *Burnet,* 287 U. S. 299; *Titsworth* v. *Commissioner,* 73 F. (2d) 385 (C. C. A. 3rd). It is established that the Secretary of the Treasury cannot by his regulation alter or amend a revenue law. *Morrill* v. *Jones,* 106 U. S. 466, 467. It is elementary that a regulation which amends, alters, or extends such a statute is void. *Lynch* v. *Tilden Company,* 265 U. S. 315, 321. In *Burnet* v. *Chicago Portrait Company,* 285 U. S. 1, 16, this Court pointed out that:

> The Court is not bound by an administrative construction, and if that construc-

> tion is not uniform and consistent, it will be taken into account only to the extent that it is supported by valid reasons.

In this case there are no valid reasons to support the original regulation. Although it might not be unreasonable as applied to some cases, its application would produce an unreasonable result in the instant case. It was the duty of the Commissioner in this case to apportion the old and the new stock to the original cost of the old stock. That is what he did under the amended regulation. Had he followed the original regulation he could not have done so, since the limitation contained therein would have prohibited the allocation to the new stock of an amount of the original cost in excess of its market value and would not permit apportionment to the new stock of the just proportion of the original cost of the old stock. Application of the original regulation, therefore, would have been unreasonable and would have produced an absurd result in conflict with the statute.

The case of *Arizona Grocery* v. *Atchison Railway,* 284 U. S. 370, relied upon by the petitioners is not in point. There Congress gave the Interstate Commerce Commission the power to fix reasonable and lawful rates. Acting under that power the Commission, after investigation, determined the maximum rate on a given commodity between two specific points and subsequently attempted to change its order retroactively. The Court held

that the exaction of unreasonable rates by a public carrier was forbidden by the common law; that the Congress had altered the common law by lodging in the Commission the power theretofore exercised by the courts of determining the reasonableness of rates; that when the Commission had established a maximum rate it was subject to the same tests as to its validity as would be an Act of Congress intended to accomplish the same purpose, and that the Commission was without authority to make a retroactive change in its order directing the carrier to make reparation to shippers.

The distinctions between the *Arizona* case and the case at bar seem plain. The *Arizona Grocery* case involved a statute wherein Congress had delegated to the Commission the power to establish maximum rates. The Commission, acting thereunder, made a finding of fact in a specific instance and then established a maximum rate to apply thereto. The order issued by the Commission on that finding of fact became a rule of conduct for the carrier. Contracts were made on the strength of that order and the rights and liabilities of the carrier with respect to third parties became fixed. In the instant case the Congress has not authorized the Commissioner to lay taxes. The Congress itself has laid the taxes and has delegated no other legislative functions to the Commissioner. The regulation involved was not based on a specific finding of fact but was merely a general interpretation of the

statute. Cf. *Gt. Northern Ry.* v. *Sunburst Co.*, 287 U. S. 358. There are no third parties involved and no rights have become vested.

It is elementary that the interpretation of a statute by an executive officer cannot change the law whether the interpretation be correct or erroneous. When an officer of the United States discovers that he has wrongfully interpreted a statute it is his duty thereafter to apply the statute in accordance with its terms to all cases coming before him regardless of whether they arose under the erroneous interpretation (see Board of Tax Appeals opinion, R. 34), except as he may be otherwise directed by Congress. Apparently such has long been the construction placed by the Treasury Department on internal-revenue laws. See I. T. 2152, IV–1, Cumulative Bulletin 83; S. M. 2216, III–2, Cumulative Bulletin 370. Congress has recognized this construction in many instances. Section 1314 of the Revenue Act of 1921, Section 1008 (a) of the Revenue Act of 1924, and Section 1108 (a) of the Revenue Act of 1926 all vested in the Commissioner, with the approval of the Secretary of the Treasury, discretionary power to apply amended regulations or Treasury decisions without retroactive effect unless the change was occasioned by a court ruling. Further recognition by Congress that interpretive regulations have a universal effect is found in Section 1108 (a) of the Revenue Act of 1926, as amended by Section 605 of the Revenue Act of 1928, which provides that:

> In case a regulation or Treasury decision relating to the internal-revenue laws is amended by a subsequent regulation or Treasury decision, made by the Secretary or by the Commissioner with the approval of the Secretary, such subsequent regulation or Treasury decision may, with the approval of the Secretary, be applied without retroactive effect.

The fact that Congress found it necessary to authorize the Secretary to approve a solely prospective application of the regulations is a clear indication that Congress recognized the universal character of such regulations. In fact, in explaining Section 506 of the Revenue Act of 1934, which further amended section 1108 (a) of the Revenue Act of 1926, the legislative committees stated that "Regulations, Treasury Decisions, and rulings which are merely interpretive of the statute, will normally have a universal application," and concluded that it was desirable to lodge in the Treasury Department the power to apply certain regulations with prospective effect only. H. Rep. No. 704, 73rd Cong., 2nd Sess., p. 38; S. Rep. No. 558, 73rd Cong., 2nd Sess., p. 48.

Amended regulations made under the income-tax laws have been repeatedly applied to govern transactions fully consummated before. *Murphy Oil Company* v. *Burnet,* 287 U. S. 299, 303–304; *Burnet* v. *S. & L. Bldg., Corp.,* 288 U. S. 406, 410; *Bamberger* v. *Commissioner,* 27 B. T. A. 785, dis-

posed of by stipulation, 67 F. (2d) 983 (C. C. A. 10th).[5] In the *Murphy Oil* case the regulation prescribed the method of allocating depletion to bonus and royalties. In the *S. & L. Bldg. Corp.* case the regulation prescribed the method of allocating profits from the installment sale of a mortgaged property. The regulations involved in those two cases which were similar to the regulations involved in the case at bar, were applied retroactively by the Commissioner and his action was approved by this Court. In the *Bamberger* case the regulation, as in the instant case, prescribed the method of apportioning stock after a reorganization. The Commissioner applied the regulation retroactively and his action was approved by the Board of Tax Appeals.

In *Langstaff* v. *Lucas,* 9 F. (2d) 691 (W. D. Ky.), affirmed on the reasoning of the District Court, 13 F. (2d) 1022 (C. C. A. 6th), certiorari denied, 273 U. S. 721, the court made this pertinent observation as to a retroactive change in Treasury regulations (p. 693):

> * * * it would seem axiomatic that if, under the law, the transfer did result in tax-

[5] *Larkin* v. *United States*, 78 F. (2d) 951, 955 (C. C. A. 8th), contains a statement that regulations, as statutes, are not to be applied retroactively without a clear indication that this was intended. However, the question in that case and also in the case cited as authority (*Shearer* v. *Anderson*, 16 F. (2d) 995 (C. C. A. 2nd)) was whether a regulation made under a subsequent revenue act was applicable to a prior revenue act.

> able income to the plaintiff, any erroneous interpretation of the act by the Treasury Department would not estop the government from asserting the tax, even though the taxpayer may have been misled by such interpretation. He must have known that his tax liability was determined by the law, and not by what some administrative official thought was the law. We must therefore determine what constituted taxable income under the act of 1918. * * *

The petitioners state that had the Commissioner promulgated in the first instance the amended regulation, which he now seeks to apply, the United Brokerage Company could have effected the reorganization in a manner which would have permitted the realization of most of the losses now claimed. This contention seems to be inconsistent with the position assumed by the petitioners throughout the proceeding before the Board of Tax Appeals wherein they contended for the application of subdivision (1), Article 1599 of Regulations 69 promulgated August 28, 1926. Since they asserted the case to be under subdivision (1), it is difficult to see how now they can contend that in the reorganization they relied upon subdivision (2) of the regulation.

CONCLUSION

The decision below is correct and should be affirmed.

Respectfully submitted.

STANLEY REED,
Solicitor General.
FRANK J. WIDEMAN,
Assistant Attorney General.
GOLDEN W. BELL,
Assistant Solicitor General.
SEWALL KEY,
JOSEPH M. JONES,
Special Assistants to the Attorney General.
JOHN R. BENNEY,
Attorney.

JANUARY 1936.

APPENDIX

Revenue Act of 1926, c. 27, 44 Stat. 9, 12, 14:

SEC. 203. * * *

(c) If there is distributed, in pursuance of a plan of reorganization, to a shareholder in a corporation a party to the reorganization, stock or securities in such corporation or in another corporation a party to the reorganization, without the surrender by such shareholder of stock or securities in such a corporation, no gain to the distributee from the receipt of such stock or securities shall be recognized.

* * * * *

SEC. 204. (a) The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; except that—

* * * * *

(9) If the property consists of stock or securities distributed after December 31, 1923, to a taxpayer in connection with a transaction described in subdivision (c) of section 203, the basis in the case of the stock in respect of which the distribution was made shall be apportioned, under rules and regulations prescribed by the Commissioner with the approval of the Secretary, between such stock and the stock or securities distributed;

* * * * *

Revenue Act of 1928, c. 852, 45 Stat. 791:

SEC. 605. RETROACTIVE REGULATIONS.

Section 1108 (a) of the Revenue Act of 1926 is amended to read as follows:

"SEC. 1108. (a) In case a regulation or Treasury decision relating to the internal-revenue laws is amended by a subsequent regulation or Treasury decision, made by the Secretary or by the Commissioner with the approval of the Secretary, such subsequent regulation or Treasury decision may, with the approval of the Secretary, be applied without retroactive effect."

Treasury Regulations 69, promulgated August 28, 1926:

ART. 1599. *Stock or securities distributed in reorganization.*—In the case of stock or securities acquired by a shareholder after December 31, 1923, in connection with a transaction described in section 203 (c) and article 1576, the basis in the case of the stock in respect of which the distribution was made shall be apportioned between such stock and the stock or securities distributed to the shareholder. The basis for the old and new shares shall be determined in accordance with the following rules:

* * * * *

(2) Where the stock distributed in reorganization is in whole or in part of a character or preference materially different from the stock in respect of which the distribution is made, the cost or other basis of the old shares of stock shall be divided between such old stock and the new stock in proportion, as nearly as may be, to the respective values of each class of stock, old

and new, at the time the new shares of stock are distributed, and the basis of each share of stock will be the quotient of the cost or other basis of the class with which such share belongs, divided by the number of shares in the class. The portion of the cost or other basis of the old shares of stock to be attributed to the shares of new stock shall in no case exceed the fair market value of such shares as of the time of their distribution.

This article was amended by T. D. 4164, VII–1 Cumulative Bulletin 55, promulgated April 3, 1928, by striking out the last sentence of Paragraph (2) thereof. It was further amended by T. D. 4274, VIII–2 Cumulative Bulletin 240, promulgated November 13, 1929, in which Paragraph (2) was made to read as follows (p. 241):

Where the stock distributed in reorganization is in whole or in part stock in a corporation a party to the reorganization other than the distributing corporation, or where the stock distributed in reorganization is in whole or in part stock of a character or preference materially different from the stock in respect of which the distribution is made, or where the distribution consists wholly or partly of securities other than stock, the cost *or other basis of the stock in respect of which the distribution is made shall be apportioned between such stock and the stock or securities distributed in proportion, as nearly as may be, to the respective values of each class of stock or security, old and new, at the time of such distribution, and the basis of each share of stock or unit of security will be the quotient of the cost or other basis of the class of stock or security*

with which such share or unit belongs, divided by the number of shares or units in the class. Within the meaning of the foregoing provision, securities are different in class from stocks, stocks or securities in one corporation are different in class from stocks or securities in another corporation, and, in general, any material difference in character or preference or terms sufficient to distinguish one stock or security from another stock or security so that different values may properly be assigned thereto, will constitute a difference in class. (Italics supplied.)

U. S. GOVERNMENT PRINTING OFFICE: 1938